TRADE PROGRAM

WORKING PAPER

TRADE BARGAINING IN CANADA AND THE US
DRIFTING TOWARDS REGIONALISM?

Ann Weston
With the Assistance of
Andrew Clark and Han Soo Kim

January 1992

This Working Paper Series is intended to provide a vehicle for the dissemination of the North-South Institute research on Trade. It is hoped that these papers will generate discussion and further research. Comments on the papers are appreciated and invited and may be sent to the author(s) c/o Ann Weston, Program Director, the North-South Institute, 200-55 Murray Street, Ottawa, Ontario, K1N 5M3.

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'The US now has a multi-track policy but with no clearly defined set of objectives and policy instruments: the new direction has an uncertain destination, but the journey has commenced' (Ostry, 1990a, p25)

1. Summary

This paper reviews recent trends in Canadian and US trade policy, focusing on issues of interest to developing country negotiators. In particular it seeks to explain the factors underlying the current emphasis on regionalism. In Canada the focus has been on the Canada-US Free Trade Agreement (CUSFTA), with the government participating somewhat reluctantly in the US negotiations with Mexico over a North American Free Trade Agreement (NAFTA). For the US, in contrast, the interest in regionalism has been more extensive, as reflected in the Enterprise for the Americas Initiative (EAI).

The paper begins by examining the political and economic context of trade bargaining. In both countries trade policy-making has become increasingly politicised. In the US, especially, this has constrained the Administration's flexibility in trade bargaining. In Canada there is pressure on the government to consult more broadly before developing new trade policies. Trade policy has attracted growing attention as it has become a key tool of economic management. While some industries continue to be protected, trade liberalisation is seen by the Canadian government, at least, to be a key instrument of industrial restructuring. So too, for both countries, is securing improved access to foreign markets and locations for investment.

The second half of the paper examines the merits of the regional trade bargaining strategies emerging in the US and Canada, and their implications for developing countries. For the US, the CUSFTA, NAFTA and EAI are designed to reinforce its aggressive stance in the GATT and unilaterally, as well as serving immediate regional objectives. For Canada, interest in the NAFTA and EAI is more limited - to defending its preferential status in the US market and to developing longer-term trade links with the rest of the hemisphere.

There is widespread scepticism about the US' multi-track trade policy and its compatibility with a strengthened GATT. Canada's gains from the CUSFTA are also questionable. The emergence of a Western hemisphere trade arrangement may offer some benefits to developing countries in the region, but these will be concentrated and uncertain, while there will be a price to pay in terms of concessions to the US, trade and investment diversion from third countries, diluted South-South regional integration, and a diminished role for the GATT. Canadian involvement,
though having little direct economic effect, may lead to a free trade area with an ever-expanding membership rather than a US-dominated 'hub and spoke' series of bilateral agreements. For developing countries outside the region, there is concern about being crowded out of the US market, both for goods and investment. Also important is the impact of American regionalism on the evolution of the GATT rules and procedures. One is issue coverage, another is increasing pressure on developing countries to accept reciprocity in trade bargaining. A major Uruguay Round package is essential to offset some of the trade diversion and to restore developing country confidence in the future of the multilateral trading system where, ironically, many have only recently begun to play an active role.
2. Key Determinants of National Objectives

Besides their many differences, there are a number of similarities between US and Canadian economic objectives as articulated by their present governments. Whether this has led to a convergence of trade policy in recent years is examined later.

A priority for both governments has been the need to reduce the fiscal deficit, which reached 9% of Gross Domestic Product (GDP) in Canada in 1985 and 6% of GDP in the US in 1983, and the associated public debt (see Table 1). The emphasis on public spending restraints has limited the scope for government transfers to address the problem of rising unemployment or to promote economic restructuring. On the other hand it has not deterred the governments from reducing tariffs, though it may have encouraged the use of other trade barriers (eg antidumping duties (ADD) or agricultural import quotas) as fiscally cheaper tools for domestic protection (see below).

Reducing inflation from the double digit levels recorded in the early part of the 1980s (Table 1) has been another target, and especially in Canada this has led to a policy of high interest rates (with a significant spread above US rates towards the end of the decade). This has tended to attract foreign capital and keep the Canadian exchange rate high, depressing exports.

The fiscal deficit has been a key component in the decline in US domestic savings in the 1980s, and the widening gap with investment. This has been matched by a substantial current account imbalance - the so-called twin of the fiscal deficit. A similar gap arose in Canada in the 1980s, with the growth in investment outstripping savings, contributing to a decline in the traditional merchandise trade surplus. While there is some debate about the relative contribution of macroeconomic variables and the exchange rate in resolving this imbalance, many in the US continue to emphasise the importance of trade policy.

Even though trade accounts for a small share of US GDP, the need to service the rise in debt owed to non-residents (Table 1) has focussed attention on the trade imbalance. A key objective therefore is to reduce the trade deficit - and even achieve a trade surplus, whether by export promotion or import restriction. Figures for the first half of 1991 showed some progress, but it remains to be seen whether this is maintained once economic growth (and imports) resumes.

Bilateral trade imbalances in the US have been used to justify concerns about 'unfair trade' and to legitimise both import relief and market-opening measures (see below). Two particular targets have been Japan and the NICs, which accounted for 36% and
### Table 1. Economic Indicators for Canada and the United States
(Unless otherwise indicated in billions of Canadian and US dollars respectively)

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<td>3.7</td>
<td>-3.2</td>
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<td>6.3</td>
<td>4.8</td>
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<td>12.4</td>
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<td>-32.7</td>
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<td>4.4</td>
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<td>8.1</td>
<td>8.7</td>
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<td>5.1</td>
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<td>4.5</td>
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<td>83.2</td>
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<td>129.8</td>
<td>163.0</td>
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<td>226.7</td>
<td>249.4</td>
<td>271.0</td>
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<td>27.5</td>
<td>32.0</td>
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<td>19.8</td>
<td>16.4</td>
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<td>11.1</td>
<td>10.1</td>
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<td>3.1</td>
<td>2.7</td>
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<tr>
<td>Real growth rate (%)</td>
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<td>1.9</td>
<td>-2.5</td>
<td>3.5</td>
<td>6.5</td>
<td>3.0</td>
<td>2.8</td>
<td>3.4</td>
<td>4.4</td>
<td>2.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>7.2</td>
<td>7.6</td>
<td>9.7</td>
<td>9.6</td>
<td>7.5</td>
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<td>7.0</td>
<td>6.2</td>
<td>5.5</td>
<td>5.3</td>
<td>5.3</td>
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<tr>
<td>Inflation rate (CPI) (%)</td>
<td>13.5</td>
<td>10.4</td>
<td>6.1</td>
<td>3.2</td>
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<td>3.7</td>
<td>4.0</td>
<td>4.8</td>
<td>5.4</td>
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<td>-78.7</td>
<td>-125.7</td>
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<td>-212.1</td>
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<td>-155.5</td>
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<td>2.6</td>
<td>4.0</td>
<td>6.0</td>
<td>4.8</td>
<td>5.3</td>
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<td>3.3</td>
<td>3.2</td>
<td>2.8</td>
<td>4.0</td>
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<td>National debt</td>
<td>737.7</td>
<td>825.4</td>
<td>967.7</td>
<td>1174.5</td>
<td>1373.4</td>
<td>1598.5</td>
<td>1813.3</td>
<td>1953.9</td>
<td>2086.9</td>
<td>2244.2</td>
<td>2548.1</td>
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<tr>
<td>Debt as a % of GDP</td>
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<td>27.5</td>
<td>31.7</td>
<td>35.1</td>
<td>36.9</td>
<td>40.2</td>
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<td>43.4</td>
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<td>47.0</td>
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<td>136.6</td>
<td>149.5</td>
<td>166.8</td>
<td>205.9</td>
<td>224.8</td>
<td>263.4</td>
<td>299.7</td>
<td>362.2</td>
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<td>-28.0</td>
<td>-36.5</td>
<td>-67.3</td>
<td>-112.5</td>
<td>-122.2</td>
<td>-145.1</td>
<td>-159.5</td>
<td>-172.4</td>
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<td>6.4</td>
<td>-8.0</td>
<td>-47.0</td>
<td>-99.0</td>
<td>-122.6</td>
<td>-145.4</td>
<td>-162.2</td>
<td>-128.0</td>
<td>-110.0</td>
<td>-99.6</td>
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</table>

23% respectively of the US trade deficit in 1990, whereas in 1980 the US had a trade surplus with the latter. While the Canadian deficit with the NICs is much smaller, and offset by the surplus with other countries, notably the US, it accounts for over a third of Canada's deficit with its non-US trading partners.

The heavy dependence on the US market is a critical factor in any discussion of Canadian trade bargaining. Canada ranks as a leading trading nation, coming eighth in the world trade league in 1990, or fourth if the EC is counted as one. But over two-thirds of this is with the US (Table 2). An interesting question is whether this (together with the Canada-US Free Trade Agreement) diminishes Canada's weight in international trade arenas, or in bilateral bargaining.

The high share of Canada's US trade has also led to the exploration of alternative markets (see Part 5). The issue is where to focus these efforts. Table 2 shows that Latin America has always been a smaller market for Canada than Western Europe or the EC; it now accounts for barely 6% of non-US exports, compared to 28% for the EC or 16% for the Asian developing countries. In contrast, US commercial interest in the Latin American and Caribbean region has a stronger historical basis (Table 3). In 1960, the region accounted for over a quarter of total US exports, more than Western Europe. The impact of the debt crisis, and the region's declining import growth, is reflected in the drop in its share of US exports to 14% in 1989.

Another issue in both Canada and the US is the changing composition of trade (see Table 4) and the growing manufactures trade imbalance which has been identified as a key component of the deterioration in the US merchandise trade account (eg US Trade Performance in 1988). In the US the manufactures surplus of $15.5bn in 1981 turned into a deficit of $119.1bn by 1988, though this has since improved somewhat with a resurgence of exports. There was also a substantial decline in the high-tech trade balance from $31bn to $6bn over the same period. A related issue is the declining employment in manufactures - whether in absolute numbers or as a share of total employment. For example in Canada, this fell to 1.85 mn in February 1991, from a peak of 2.14 mn in June 1989, a loss of almost one in seven jobs.

There has been a major debate on how to reverse this trend - whether by macroeconomic, trade or industrial policies (Part 4). With only small surpluses in agriculture and services, some have argued (eg, US Trade Performance, p18) that improvements must come primarily in manufactures trade - with some 'significant structural adjustment challenges for some trading partners who have come to rely on ever-expanding
Table 2. Direction of Canadian Exports and Imports

<table>
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<tr>
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<th>Exports Distribution of Total X</th>
<th>Distribution of Non-US X</th>
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<tbody>
<tr>
<td>World</td>
<td>5420 12420 67730 1209730 100.0 100.0 100.0 100.0</td>
<td>100.0 100.0</td>
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<tr>
<td>D-ed Countries</td>
<td>4900 11330 54742 1063000 90.4 91.2 80.8 87.3</td>
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<td>990 n.a. 1880 n.a. 18.3 13.5 n.a. n.a.</td>
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<td>E.C.</td>
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<td>n.a. n.a. 31.6 27.8</td>
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<td>35.7 18.3 10.2 8.4</td>
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<td>U.S.</td>
<td>3740 8810 41068 85305 60.0 70.9 60.8 70.7</td>
<td>n.a. n.a. 100.0 100.0</td>
</tr>
<tr>
<td>Japan</td>
<td>120 560 4238 7429 2.2 4.5 6.3 6.2</td>
<td>7.1 15.5 15.9 21.0</td>
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<td>D-ing Countries</td>
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<td>29.2 27.7 28.6 27.8</td>
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<td>15.8 16.1 10.9 5.8</td>
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<td>Mexico</td>
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<td>Asia</td>
<td>210 317 2305 557 3.9 2.5 3.4 4.6</td>
<td>12.5 8.6 8.6 15.6</td>
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<td>Korea</td>
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<td>China</td>
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<td>Africa*</td>
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<th>Imports Distribution of Total X</th>
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<td>100.0 100.0</td>
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<td>0.7 2.3</td>
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<td>1.1 2.0 2.3 2.6</td>
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*Includes South Africa

Derived from UN, Handbook of International Trade & Development Statistics, 1976
IMF, Directions of Trade, 1983 & 1990
Table 3. Direction of US Exports and Imports

[Million US dollars, %]

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<td>339360</td>
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<td>10360</td>
<td>n.a.</td>
<td>n.a.</td>
<td>25.9</td>
<td>26.5</td>
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Source: Derived from UN, Handbook of International Trade & Development Statistics, 1976
IMF, Directions of Trade, 1983 & 1990
manufactures trade surpluses (with the US) as a major source of their economic growth'.

In addition to its large car exports to the US, Canada's trade remains highly dependent on its agriculture and natural resource industries (see Table 4). This explains Canada's priority in the Uruguay Round to resolving the EC-US agricultural subsidy trade war and the reduction of tariff escalation on processed products.

Besides so-called unfair behaviour by trading partners (eg closed import markets, undervalued currencies, or dumping), considerable attention has focussed on the declining competitiveness of US and Canadian products, associated unemployment (particularly in manufacturing), and appropriate remedial action.

Finally, in both countries, increasing attention has been given to the flows of private foreign investment (PFI) - both inward and outward. An interesting feature of the 1980s is the sharp influx of PFI into the US (including from Canada), responding to concern about access to the US market as well as the depreciation of the dollar (after 1985) and an increase in the global movements of capital. This has influenced trade policy. In Canada the desire to be a competitive site for investment location was an important driving-force behind both CUSFTA and the decision to join the NAFTA negotiations (see below). US corporations have also sought changes in Canadian and Mexican investment and trade regulations to ease their location decisions.

To sum up, improving trade performance through trade policy initiatives has been a key US objective. The US has emphasised manufactures and bilateral trade balances with several countries. Canada has had a narrower bilateral focus - a major goal being to secure access to the predominant US market. Preoccupation with inflation, however, by raising interest rates and thus the exchange rate, has affected exports.
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<td>69.06</td>
<td>92.61</td>
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<td>Total</td>
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Note: Commodities which are not classified according to kind are included in total.

Source: Derived from GATT, International Trade 88-90, Volume II, 1990
3. Political Process

Trade bargaining in the US and Canada has been increasingly politicised, but while this is reflected in mounting influence of the political process in US trade policy, in Canada there has been little such change. Politicisation results partly from the growing dependence of both economies on trade with the globalisation of economic activity. Also important is that trade is no longer seen as a technical, legalistic or narrow subject but one touching a wide array of issues relating to sovereignty and social welfare.

For instance, the so-called 'Great Debate' in Canada over CUSFTA became very heated because it clearly went beyond the traditional focus on border measures, touching several subjects sensitive to domestic sovereignty eg investment, energy, and culture. In addition there was widespread concern that, given the predominance of the US, a bilateral agreement would lead to the erosion of Canadian standards, not just technical, but also other social standards (eg health care, working conditions) generally considered above those in the US. With the proposed NAFTA, the focus in both countries has broadened further to include environmental standards as well as labour rights.

The process of trade policy-making in the US has been diffuse - shared between Congress, the Administration and the private sector. But with recent changes in trade legislation the Administration's authority has been diminished.

According to the US Constitution, Congress is responsible for making and executing US trade policy. For several decades, however, it has delegated negotiating and executive authority to the Administration (as under the Fast-Track Authority), primarily to reduce political pressure from narrow interest groups. Nonetheless Congress, notably through the House Ways and Means Committee, and the Senate Finance Committee, retains substantial influence, both through the formulation of trade legislation, and through the more frequent scrutiny of the Administration's performance on trade, for example demanding regular briefing from the US Trade Representative (USTR) on the progress of disputes over unfair trade practices.

The 1988 Omnibus Trade Bill incorporated several changes reflecting Congressional concern that the Administration was giving inadequate attention to domestic interests compared to diplomatic priorities. For example, the growing importance of the USTR will reduce the influence of other departments and their capacity to bring a broader perspective to US trade policies. Some observers have even suggested that the White House has lost initiative on trade to Congress, with the result that US trade policy is now essentially 'made-in-Congress'.

3
The debate in early 1991 over the extension of the Administration's Fast Track Authority for the Uruguay Round and the NAFTA negotiations, underlines the fragility of the process - its political vulnerability and the possibility of it being revoked. The heightened political interest in a NAFTA has led to a rising number of Congressmen wanting to help define trade policy. At the same time a new alliance has emerged of labour, environmental and church groups, concerned that the expansion of trade helps to raise social standards in Mexico, rather than to erode those in the US. These joined with like-minded groups in Mexico and Canada to form a cross-border coalition in opposition to the NAFTA.

Besides consultations with Congress and the various government agencies, the President through the USTR draws upon a network of private sector advisory committees. There are also a large number of private sector groups which have been set up to monitor and lobby both the Administration and Congress, playing a 'pluralist activist' role (Ostry, 1990a, p.19). Their efforts to influence both legislation and executive decisions have grown with their interest in trade. Complexity of US trade policy is another factor; as ECLAC (1990, p. 18) notes, monitoring has become important with the very detailed calendars for policy implementation in the 1988 Trade Act.

The groups cover a considerable range, in perspective and influence, from small industry specific groups such as the Flower Retailers' Association to large groups such as the US Chamber of Commerce, and Consumers for World Trade. Banks typically have maintained a low profile in discussions of US import policy, despite their interest in debt-servicing, though on banking and financial services they have been strong supporters of the US policies of reciprocity and market-opening under the threat of retaliation.

Foreign lobbying efforts have increased in parallel. According to figures published by the US government, expenditures by all foreign agents, who must be officially registered, amounted to some $451 million in 1989, less than one percent of the value of US imports (ECLAC, 1990, p. 5).

While several authors have commented on a growth in pro-traders, including the large service corporations, it is not clear that these necessarily oppose import-competing interests. An important fallout from the 1988 Trade Act, and in particular the toughened 301 provision is the weakening of the pro-trade/anti-protection coalition (Finger 1991, p20). Exporters no longer need to support import liberalisation in the US to improve their access to other markets. In essence, the 1988 Act substitutes maintenance of existing access to the US market (rather than new import concessions) in return for better access to foreign markets. Failure by foreigners to open up will lead to restrictive retaliation.
In Canada, a very different political culture is reflected in Parliament playing a minor role in trade policy-making, in sharp contrast to the US Congress. This changed somewhat in 1987-88 with the negotiation of the free trade agreement with the US, which was a major issue of Parliamentary debate. The proposed extension of this agreement to include Mexico has also begun to cause political controversy.

Trade relations with other countries continue to spark little interest in Parliament as a whole. Exceptions are the Commons' Standing Committee on External Affairs and International Trade (SCEAIT), and the Senate Standing Committee on Foreign Affairs, which have reviewed and offered advice on Canadian trade policy. For instance a SCEAIT report on third world debt urged the government to take account of the interests of indebted countries in the Uruguay Round discussions (1990, p. 59).

But neither body has had much influence. As a recent SCEAIT report noted: 'The Canadian tradition and system, unlike the American, gives Parliament only a very marginal role in the making of trade policy, confining its participation to bringing Canadian law into conformity with treaty obligations' (1991, p24).

There is little political accountability - majority governments have been able to pass trade agreements. They are presented for approval, rarely for advice let alone amendment. SCEAIT's cross-country hearings on the FTA were held without a full and final text being available for review, and with a severely limited time for discussion. In the case of NAFTA when the trade minister sought SCEAIT's advice on Canada's role in the negotiations between the US and Mexico, the decision to participate was taken before these deliberations had concluded. SCEAIT has called for this process to change: 'This tradition is now dangerously obsolete because the rapidly changing nature of the international system is blurring the old distinctions between what are strictly domestic and international concerns. In these new circumstances, political debate of international trade policy is inevitable and political consensus desirable if not essential' (ibid).

In contrast, the government has held regular consultations with the private sector during negotiations on the Uruguay Round, CUSFTA and now NAFTA, through 15 sectoral advisory groups on international trade (SAGITs) and an overview committee (the International Trade Advisory Committee - ITAC). While the government has typically used the gains in market access secured through trade negotiations to win support for domestic liberalisation, it has been constrained by opposition especially in the labour-intensive low-tech industries such as clothing and footwear.
Changes in trade law in the 1980s in both Canada and the US have granted the private sector greater access to trade remedies, and thus, resulted in the 'privatization of trade policy' (Ostry, in Trebilcock and York, 1990, p17). For example, in the US the Omnibus Trade Bill of 1988, the time limit for safeguard action under Section 201 has been extended from 5 to 7 years; injury no longer has to be proven for relief against patent infringements under Section 337; new criteria make it more likely injury will be found in CVD cases; the grounds for dumping have been extended to include input dumping and circumvention.

In Canada, the Special Import Measures Act of 1985 extended the right to bring safeguard complaints to any producers (provided they constitute a major share of their industry) - this 'direct access' provision had previously been limited to textile and clothing producers. There were two positive aspects of the Act, however. One was the introduction of a public interest provision, under which the benefits of import relief are to be weighed against the costs to consumers, retailers, and others. But this is to be applied with discretion ie not in every case, and the findings are not binding on the finance minister. A second was a 5-year sunset clause requiring ADD and CVD cases to be reviewed before extension.

Another recent positive development was the creation in 1988 of the Canadian International Trade Tribunal. This replaced inter alia, the Textiles and Clothing Board, which had been closely associated with the domestic industry. Besides its judicial functions, it may undertake at the government's request general trade enquiries, and this may lead eventually to more transparency in trade policy-making. While it is still primarily used to implement existing policies, as the government's trust in it grows it could become more involved in the development of policy.

A final dimension to be taken into account is the division of responsibilities between federal government and the provinces or states. In Canada, the constitutional crisis, triggered by the failure to accommodate Quebec's demands for special status, has led to a review of federal-provincial relations. Trade bargaining has begun to be affected as the negotiations move into areas of provincial responsibility like unemployment insurance or liquor laws, and some doubt whether the provinces will implement whatever is agreed internationally. Similar concerns have arisen in the US, eg over environmental regulations.

To sum up, the trade policy process in the US, while driven by an increasingly active private sector, is highly politicised both in day-to-day management and in the negotiation of new legislation, including international agreements, notwithstanding the fast-track authority. This has important implications for bargaining - the Administration's flexibility has been seriously
constrained, including its ability to take into account broader economic and diplomatic factors. In contrast the Canadian government has been able to develop and implement new trade policies with minimum consultation, even in the face of considerable opposition. While this may have weakened the government's bargaining position, the key underlying factor in negotiations with the US has been the difference in economic strength.
4. Trade and Industrial Policy

Driven by concerns about industrial competitiveness, there has been considerable discussion in Canada and the US over the role of trade and industrial policy in economic management. In the past both countries attempted to resist pressures for protection and managed trade, appealing to the GATT principles of trade liberalisation, multilateralism and non-discrimination.

But the list of exceptions has been growing. This happened first at the level of individual products, with various arrangements designed to restrict access for particular imports, or to promote access for particular exports. A more recent phenomenon, at the level of markets, is the conclusion of the bilateral Canada-US free trade agreement, the ongoing negotiation of its trilateral successor with Mexico, and the proposed extension of free trade discussions to the rest of the hemisphere. It could be argued that these regional trading arrangements constitute a strategic trade policy response to changes in the world economy and the international trade regime (Ostry 1990a, Eden and Molot 1991, Hart 1990). Exactly how such regionalism fits into the trade bargaining strategies of the US and Canada, and whether it is likely to be any more successful than previous or parallel strategies, is the subject of parts 4 and 5 of this paper.

Both Canada and the US have generally supported trade liberalisation. But, while recognising the importance of underlying macroeconomic factors, both have attempted to deal with sectoral trade problems through the maintenance of high effective tariffs, quotas or VERS, ADD or CVD (see GATT, 1990a and GATT, 1990b). Typically these have involved the labour-intensive, low-technology industries (clothing, footwear etc). For example both Canada and the US have negotiated increasingly restrictive VERS for clothing under the Multifibre Arrangement, going against the trend in other importing countries. While QRs against footwear have ended recently there continue to be high tariffs, and a series of ADD.

There have also been a patchwork of policies introduced, sometimes on strategic grounds, to support higher-tech industries in the US especially, by restricting access to the domestic market, such as the VERS on steel, cars, and machine tools. The agreement with Japan over semiconductors marked a new departure in that it included a minimum price level to be adhered to in third country markets, as well as a target share for US exports to Japan. More generally, changes in US trade law (notably the 1988 Trade Act) provide an aggressive response to foreign exporters, in that they aim to curb practices which give the US' competitors 'unfair' advantages.
Backing up these border measures have been various industrial support programs. In the US support has come, for example, in the form of defense contracts, other public procurement policies, and then more recently an exemption from the antitrust law, to allow companies to do collaborative research.

Such an array of ad hoc, reactive measures has satisfied neither those in favour of non-intervention and trade liberalisation nor supporters of a more coherent and comprehensive strategic trade and industrial policy. The latter argue US trade policy is inadequate - both in restricting imports (protection has been porous) and in opening export markets - while industrial policy needs to be strengthened, for example through more public support of research and training and other types of programs available to competitors in other countries. Failure to do so is argued to have led to the aggressive use of ADD - 'a privatized trade policy that is far from optimal for the country as a whole' (Tyson, 1990, p55). On the other hand, it is questionable whether the division of trade policy powers lends itself to strategic trade policies.

Neither the CUSFTA nor the proposed NAFTA were initially perceived to be central to US industrial policy - certainly neither was initiated by the US. But both have important implications for US industry and especially that growing share of US corporations with global linkages. The CUSFTA provided these firms with the opportunity to rationalise production between their Canadian and US plants. (It also provided other benefits such as more secure access to Canadian energy and to investment in Canada.) Despite a few unresolved and sensitive issues (such as subsidies and binding US trade practice to settlement by a bilateral panel) the NAFTA was not controversial, and it won Congressional support.

In contrast the heated debate over NAFTA suggests this is of much greater strategic interest. Even though the bilateral trade and investment links are as yet much smaller, they are growing rapidly (see Table 5). Besides the opportunities for increased exports and investment, many are concerned about the possible negative impact on employment in labour-intensive and even some high-tech import-competitive industries in the US - an issue which did not emerge in the CUSFTA given the much smaller differentials in labour costs between Canada and the US. One issue which has been raised is whether competition with lower Mexican wage costs will undermine efforts, eg in autos, to shift US industry to a high-tech knowledge-intensive growth path (see, for example, Herzenberg 1991).

Developments in Canada have been somewhat different, dictated partly by the smaller domestic market. Until the late 1970s the Federal industrial policy involved the maintenance of relatively high effective tariffs, and some non-tariff barriers, amid an
Table 5. US Trade and Investment Links with Canada and Mexico

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<td>US share in FDI</td>
<td>75%*</td>
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<td>(72% in 1989 flow)</td>
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Note: *1983
Source: Derived from IMF, Direction of Trade Statistics 1987 and 1991, and USITC and Investment Canada
array of other policies designed to promote industrial output, and reduce dependence on the export of semi- or unprocessed natural resource products. An important dimension was the promotion of regional development. Trade policy, besides maintaining protection of certain sensitive industries, was designed to promote trade with third countries and so lower dependence on the US market. This was sought primarily through the GATT.

Since the mid-1980s the federal Conservative government has introduced a series of radical changes, in keeping with its non-interventionist ideology and the attempt to reduce the fiscal deficit. The trade, industrial and regional assistance programs, considered by some to have been a failure, have been gradually cut back. The Western and Atlantic Canada programs have been separated from industrial support, while the latter has shifted from being grants-oriented to service- and knowledge-oriented and non-firm specific. According to Doern, this resulted from 'a lingering fear, only partly addressed in the CUSFTA, that many Canadian industrial policy actions used in the past will be subject to countervail challenges under American trade law on the grounds that they are trade distorting' (1990, p56).

Instead the CUSFTA has become a key tool of industrial as well as trade policy. It was designed to promote rationalisation of Canadian industry, and to increase productivity through the achievement of economies of scale, offered by more secure access to the large US market. This in turn was expected to attract private foreign investment to Canada (while provisions to protect growing Canadian investment in the US from nascent nationalism were also important). At the same time CUSFTA was intended to prevent a return to previous interventionist policies (subsidies, screening of most investment, differential energy prices etc) many of which would be illegal under the CUSFTA.

Further industrial restructuring is likely with a NAFTA, though it is too early to conclude that the benefits will outweigh the costs. In this case the stated strategic interest has been essentially a defensive one ie to secure investors in Canada the same market access as available to investors in the US. Canada also wants to help develop the rules (eg of origin) and the timetable which will govern its competition with Mexican products in the US market.

Growing concerns about this minimalist approach to industrial policy, at a time of recession, declining competitiveness exacerbated by an appreciating exchange rate, and growing regional inequities, have led many Canadians to call for additional measures - ranging from active labour market policies (especially training), to support for research and innovation. A new 'competitiveness' strategy was expected in late 1991, following the merging earlier in the year of the ministerial
responsibilities for international trade and industry, science and technology. But it is unlikely to amount to an active industrial policy, as this 'requires a level of political-technical-entrepreneurial capacity and cohesion that simply does not exist ... in Canada' (Doern, 1990, p60). There are also doubts as to whether it could be entertained under CUSFTA.

To sum up, trade policy has assumed a predominant role in economic management in Canada and the US. In both cases this partly results from an attempt to curb government spending - trade policy being cheaper than industrial subsidies, for example. Trade protection still underpins a number of sensitive industries in both countries. But in Canada, domestic trade liberalisation is seen by the present government as a key instrument of industrial restructuring. So too, for both the US and Canada, is securing improved access to key foreign markets and locations for investment. The strategies used to pursue these objectives are subjects of the next section.

The efficacy of this approach is not just an issue of domestic interest. Without a more supportive network of policies, whether national or supranational (following the EC model), concerns about adjusting to free trade with Mexico may weaken support in Canada and the US for closer economic links with developing countries. It has already been suggested in the US that job losses in particular sectors arising from a NAFTA could be offset by stricter controls on third country imports. For developing countries there is also a broader generic issue, of the legitimacy of government intervention in managing economic change. Some may be concerned about the precedents being established in the context of both the CUSFTA and a NAFTA. There may be pressure to extend this approach to countries associated with the US and Canada through the Enterprise for the Americas Initiative, and even to other developing countries through the GATT.
5. Trade Bargaining Strategy

The emergence of a regional dimension in US and Canadian trade bargaining strategies can be traced to a number of factors (such as industrial strategy). But whether these justify giving priority to a regional strategy rather than alternative strategies is a matter of debate.

A key factor has been the US' frustration with the GATT process. The GATT's day-to-day practices (such as dispute settlement) have proved too slow, or its rules (e.g., on dumping) too inadequate to deal with what many in the US consider 'unfair' trading practices (e.g., non-enforcement of workers' rights, currency undervaluation). These concerns have been reinforced by a perception that the US market - which accounted for a major share of world import growth in recent years - has been the mainstay of the multilateral trading system. The US has therefore been a prime mover in the Uruguay Round negotiations behind more stringent rules as well as the addition of new issues (like services) in which it has a strong export interest. But the slow pace of the negotiations, and the difficulty of securing a GATT consensus which meets most of its objectives, have led the US to pursue a multi-track policy - of unilateralism, bilateralism and regionalism, alongside multilateralism.

Another concern has been the strengthening of regional economic integration in other parts of the world, notably the EC, and within the Asia-Pacific basin. This is not just an issue of access for exporters, but also about ease of investment flows. In response, the US has sought to strengthen its own regional trade and investment arrangements.

This is not to suggest that the GATT is no longer important to the US. Indeed, the US has continued to be actively involved in the GATT, for example, in terms of contributing proposals in the Uruguay Round and in bringing disputes for multilateral settlement. Success in the GATT remains the priority - e.g., to resolve disputes with the EC over agriculture or to secure access to global services markets. But its stance within the GATT has become more aggressive, backed up by the pursuit of alternative strategies outside the GATT. These have various objectives - i.e., speed, ii. to act as a catalyst and lever in the GATT, and iii. insurance against the spread of regional blocs. Besides its immediate interests, in striking bargains outside the GATT, the US has sought to achieve longer-term and broader systemic objectives.

Outside the GATT, the US has pursued an increasingly aggressive and essentially unilateral trade strategy (Bhagwati and Patrick, 1990; see also GATT, 1990a). This has targeted a number of NICs and emerging NICs, such as Korea and Thailand respectively, and
Japan. A number of elements illustrate the toughness of this new strategy.

First, it is unilateral in that the US has sought changes in other countries' practices without offering any new concessions in return. Action under section 301 is often discretionary - for example, the criteria for determining whether a foreign trading practice is unjustifiable may be applied in a discretionary manner. Bargaining has been limited, though some countries have been able to secure more lenient treatment, for example a slower timetable for compliance with US demands. In several instances the US has been prepared to accept VERs instead of proceeding with ADD or other import relief measures. In response there has been greater recourse to the GATT to overturn US trade actions, but the number of cases against the US still represents a small fraction of the US total.

Second, a new element in US trade policy is the increasing scope for the Administration to self-initiate action against 'unfair' traders, rather than waiting for petitions from domestic industry.

Third, the US has focussed on changing other countries' domestic regulations governing imports and other issues such as intellectual property, as well as their export practices. For example, following a section 301 petition and a series of ADD proceedings, an agreement on semi-conductors was signed with Japan to improve US access to the Japanese market and to prevent dumping in third-countries. In return the 301 and ADD proceedings were dropped.

Fourth, such US practice often goes beyond the GATT, in that some of these areas are as yet outside the GATT's competence - notably intellectual property, insurance, and workers' rights. There is also an emphasis on results rather than rules. In some cases the US has introduced more restrictive interpretations than those written into the GATT, such as the rules governing countervailing duties. Under the 1989 Structural Impediments Initiative with Japan, regular discussions are held on structural constraints facing US business operations, such as keiretsu cross-shareholding and other practices the US considers anti-competitive. Even where applying GATT rules, the tight timetable in the 1988 Trade Act allows for retaliatory action without prior sanctioning by the GATT Council.

Another element of aggressive trade policy concerns agricultural export subsidies under the Export Enhancement Program. This 'war-chest', of $2.5bn established in 1988, has sought to win back market share from the EC, particularly for wheat, but exporters in third countries eg Canada and Argentina have been affected. It has also supported US rice, cotton and other exports where developing countries are major suppliers (eg Thailand and Egypt respectively).
While not averse to using discriminatory measures (such as VERS) at a product level, the US has long been an opponent of discriminatory bilateral or regional agreements such as the EC or Commonwealth preferences. It began to break with this tradition first with the Caribbean Basin Initiative (a package of unilateral but highly circumscribed concessions for Caribbean exports to the US introduced in 1984). More far-reaching have been the agreement with Israel, CUSFTA and now the proposed NAFTA. Informal discussion of a NAFTA dates from at least 1979 when Congress asked the Administration to examine different types of trade arrangements in North America. President Reagan spoke of a North American accord in his first year in office, but this was dropped after lukewarm reactions from Canada and Mexico (Curtis, 1985, p180).

In none of these agreements has the US been the demandeur, though its positive response has reflected strong interests - both from a longer-term systemic perspective as well as immediate trade and investment objectives. As Treasury Secretary Baker reiterated on several occasions in 1988:

'we are seeking a healthy dynamic linkage between bilateral and multilateral initiatives so as to prod and reinforce the GATT... the rewards of this agreement offer an incentive to other governments. If possible, we hope this follow-up liberalization will occur in the Uruguay Round. If not, we might be willing to explore a "market liberalization club" approach, through minilateral arrangements or a series of bilateral agreements' (Baker, 1988).

Similar arguments have been used by advocates of FTAs outside the region - whether in the OECD-plus or in the Asia-Pacific (see Lawrence and Schulze 1990). But various reasons, partly a continued preference for dealing with most countries within the GATT and partly a reluctance to embark on free trade with some more competitive countries, have precluded these options from being pursued more broadly (Schott, 1989).

In the case of Mexico, the US has other important objectives - political, immigration, debt and development. Many of these objectives also underlie the proposed extension of US regionalism to include the rest of the hemisphere in the US' Enterprise for the Americas' Initiative (EAI).

Canadian trade strategy until the early 1980s could also be summarised as 'mainly multilateralist'. As a smaller nation heavily dependent on trade, the GATT offered an effective means to prevent its larger trading partners (especially the US) from introducing unilateral trade restrictions (Stone 1984, Curtis 1985). It also offered a means to reduce dependence on the US market by promoting trade with third countries. But growing concerns about US protectionism, coupled with a recognition of
the US' unwillingness to deal in the GATT, and especially its preparedness to move faster with likeminded countries, led Canada to adopt a 'broadly bilateralist' path. Moreover several analysts thought that, while attempts to reduce dependence on the US should continue, they were not likely to be very successful.

Initially (in 1983) the Liberal government considered a sectoral approach, partly because most changes were predicted to be intrasectoral, and also because it would have fewer negative implications for political sovereignty. But negotiations were extended to a broad range of sectors and non-trade issues, partly to meet the broader domestic objectives of the new Conservative government (as outlined above) and partly to provide the sidepayments being sought by the US.

Apart from its immediate objectives, CUSFTA was meant to change the dynamics of Canadian trade negotiations with other countries in the GATT, notably Japan and the EC, which would have to pay for entry to Canada on same terms as US. Previously they had been able to secure the same treatment under the GATT's most-favoured nation rule.

The third and most recent phase of Canadian trade strategy, which is still in the making, can be characterised as one of 'reluctant regionalism'. Canada has been involved in some loose regional initiatives, such as Pacific Basin Economic Cooperation, but on the understanding that this should not undermine multilateralism - by being open to other members, and working to reinforce the GATT. The suggestion of a free trade agreement between the US and Mexico in early 1990 took many in Canada, including the government, by surprise. The government continued to be overtaken by the Mexican and US political timetables which led to the negotiations being launched earlier than expected. As a result the government was forced to decide whether to participate even before the parliamentary committee, which had been asked by the trade minister for its advice, had finished its deliberations about the appropriate trade strategy.

The strategy that has been adopted is a defensive and reactive one. There is no evidence that Canada would have sought a free trade agreement with Mexico without the US doing so. It is also unlikely that Canada would enter into free trade discussions with South America and the Caribbean without the US Enterprise for the Americas Initiative. Renewed Canadian interest in the region dates from a Cabinet review in 1988 which has led to various Canadian initiatives notably full membership in the Organisation of American States in 1990. But Cabinet has yet to approve moving from framework trade, investment and/or tax accords to fully-fledged free trade agreements with the region.

A chief reason for participating in the NAFTA negotiations is to ensure that Canada offer the same advantages as a location for
investment as the US - ie one with free access to all three markets. If the US proceeds to negotiate a series of free trade agreements, first with Mexico, and then the rest of the hemisphere, a 'hub and spoke' system could emerge ie the US, as the 'hub', would have (ceteris paribus) the locational advantage over any of the 'spokes' (Wonnacott, 1990).

Another objective is to protect Canada's recently acquired interests in the US market, by being involved in the negotiations on the auto sector, the rules of origin, and the phasing of liberalisation. Several studies have underlined the possibility of trade diversion, as Mexican products overlap with many Canadian ones (eg Magun 1991, Treloa and Whalley 1991).

It is not clear, however, what bargaining chips Canada has either with the US or with Mexico. With recent experience of US objectives and bargaining techniques, Canada may be able to help Mexico on some issues. There may also be areas of mutual interest such as the strengthening of the dispute settlement provisions, or discussions with the US on subsidies and dumping - leading to more progress than either would be able to achieve independently (Hart, p129). But Mexico already appears to be moving further than Canada eg on culture and intellectual property, though not on energy. And both Mexico and the US have stated clearly that if Canada proves obstructive, it will be asked to leave the negotiations.

Some critics (including a former CUSFTA negotiator) have argued that, by entering into new trade negotiations with the US, Canada risks reopening the CUSFTA. The US has stated it will seek concessions on cultural industries and drug patents which Canada was unwilling to make in CUSFTA. For its part, Canada might seek additional concessions on financial services and government procurement. An alternative may be for Canada to negotiate its own bilateral agreement with Mexico. This would deal with the locational issue, without influencing the shape of the US-Mexico deal. One drawback, however, is that if this approach were then followed in the hemisphere, it could lead to a complex set of trade agreements, each with their own rules of origin etc.

Another suggestion has been that Canada pursue closer trade relations with the EC, Japan, or even ASEAN, which are more important markets.

Mexico is a minor market for Canada compared to many other countries, though it is the largest in the hemisphere after the US. There is longer term potential, but even this may be limited compared to other developing countries with much larger domestic markets such as China, India or Brazil. Nor does Canada share the US' geostrategic interest in the region. Immigration, though an important policy issue in Canada, with a growing number of immigrants from Mexico and further South, is not as sensitive as in the US.
There may be a stronger development rational for Canada accepting the Enterprise for the Americas Initiative (EAI) - it already has preferential trade with several countries in the Caribbean, under CARIBCAN, and wider bilateral aid interests in many parts of the region. However these links are considerably weaker than those with many other extra-regional countries, some of whom face the probability of trade diversion as a result of the EAI. For example, in the aid area, only two Latin American/Caribbean countries fell in Canada's top 25 recipients in 1988-89 - Jamaica (3rd) and Peru (19th), with 2.6% of the total. In contrast the US aid program gives greater priority to the region with 9 countries in its top 25, accounting for 11.3% of total US aid.

The GATT's importance for Canada has inevitably been diminished by the CUSFTA. At the 1991 G7 summit, when commenting on the possible consequences of a Uruguay Round failure, the prime minister contrasted Canada's more fortunate position (with CUSFTA and the prospect of a NAFTA) with that of many developing countries. But GATT still has a significant role to play in the promotion of Canadian trade interests. This is reflected in Canada's very active participation in the current negotiations. Canada has three primary objectives - to strengthen GATT rules on agricultural export subsidies; to increase the efficacy of the GATT, and especially the dispute settlement mechanism; and to promote access to third markets, in new and old areas.

In order to increase the priority given to agricultural reform, Canada helped constitute the Cairns group, which jointly represents a quarter of world agricultural exports. But its contribution to this group has been somewhat compromised by domestic opposition to substantial import liberalisation in those sectors which presently benefit from supply management (dairy, poultry).

The GATT mechanisms for dispute settlement and market liberalisation are important for Canada's dealings with third countries - it does not have the same scope as the US for bilateral let alone unilateral bargains. They also have a role to play in residual areas of bilateral disagreement - both disputes with newly agreed rules, and areas where new rules could not be agreed (such as subsidies or transport). Canada has pursued these issues with several individual and some joint proposals, eg with other members of the informal like-minded group (known as the De la Paix group).

The results of these various strategies are summarised in the next part of this paper.
6. Results and Implications for Developing Countries

It is too early to draw firm conclusions about the benefits and costs of this new regionalist thread in Canadian and US trade policy. The fate of the Uruguay Round is still in the balance, though hopes for a major deal are fading fast. A key issue in the CUSFTA, subsidies, remains to be resolved, while the details of a NAFTA, let alone the modalities of the EAI, still have to be finalised. Canada may yet leave the NAFTA negotiating table. Failure of the US to get a NAFTA through Congress, for example, could lead to a major rethinking of the EAI. What follows therefore are a set of speculative comments, drawn from the preceding analysis, focussing in turn on the interests of the US and Canada. The final section speculates about the implications for developing countries - distinguishing between Mexico, the rest of Latin Americas and finally those outside the hemisphere.

In several respects the US policy of aggressive unilateralism appears successful. It has secured several VERs and other trade-restricting concessions - in 18 of the 26 cases where it threatened retaliation from 1985 to 1988 (Ostry, 1990a, p26). A number of countries have made market-opening commitments and agreed to modify their intellectual property laws in response to US demands. Some have gone even further eg Korea and more recently Brazil have disinvoked their right to use GATT Article XVIIIB (allowing safeguards for balance of payments purposes).

It has been argued these market-opening measures more than offset the trade-restricting commitments and thus on balance US trade policy has contributed to world trade growth. But this begs a number of issues. First, some of these market-opening changes would have occurred anyway, with the present trend of liberalisation and deregulation in many countries. Second, some of the commitments favour US exporters ie they contribute to the evolution of a discriminatory, fragmented world trading system. Third, while this strategy has resolved some immediate irritants, it has not removed the major factors underlying the US trade imbalance ie domestic macroeconomic policy. Nor does it appear to have stemmed the desire of Congress to become more involved in trade policy.

The success of the bilateral agreement with Canada lies partly in the terms the US was able to secure for its exporters, investors and buyers of Canadian energy. It has also spawned several other bilateral discussions particularly under the Enterprise for the Americas Initiative (EAI) - by mid-July as many as 16 countries had signed framework agreements with the US, with the 14 Caribbean nations following soon after. Many expect to begin FTA negotiations with the US once the NAFTA talks conclude.

At the same time it has contributed to renewed regional accords within Latin America. The extent to which this regional
activism was accelerated by the EAI, which suggests a preference for negotiating with 'groups' of countries, rather than other factors, is outside the scope of this paper. Certainly there were already signs of renewed South-South cooperation, both regionally and more broadly.

Others outside the region are also interested, yet it remains to be seen whether the US can, or wants to, fulfil these expectations, either regionally, or extraregionally. This will partly depend on the size of the anticipated payoffs - both economic (ie including trade and investment) and non-economic (eg the impact on immigration) - and how this compares to the gains to be secured in the GATT.

There is concern in the US about the implications of a string of FTAs, whatever their individual merits - '.... proceeding piecemeal will result in a complex crazy-quilt system in which US trade with different partners is subject to different regulatory regimes' (Lawrence and Schultze, 1990, p23). The complexity of trade relationships within the hemisphere will be compounded with an ever-extending web of criss-crossing agreements. There is also likely to be less liberalisation with piecemeal negotiations, with less scope for trade-offs. In the case of the EAI, these concerns may be addressed by a plurilateral approach; but the optimal approach may still be to work through the GATT.

The implications for the GATT, and US participation in the GATT, are mixed. Some aspects of CUSFTA have been used as a model for the Uruguay Round texts; CUSFTA has also illustrated to others the US' priorities and limitations, eg the exclusion of transport. On the negative side, it is possible that these unilateral, bilateral and regional 'quick-fixes' may weaken domestic commitment to the GATT, and the obligations which go with GATT membership. One instance is the emerging US preference for reciprocal deals on financial services rather than an arrangement based on the Most-Favoured Nation principle. This trend would be a blow for many ldc's and also the emerging Eastern bloc, for whom the multilateral trade regime remains so important.

Another issue is that of trade diversion. A successful Uruguay Round ie one which involves major cuts in US (as well as Canadian and Latin American) protection is needed to minimise the trade diverted from third countries.

Finally, the aggressive policy of agricultural export subsidies, coupled with a threat to pull out of the Uruguay Round, may have helped to raise the volume of US exports, but at the expense of many other exporters besides the EC, and at great domestic expense. Neither can be continued indefinitely, yet there is little sign the EC is prepared to make the major changes sought
by the US. The inability to reach a compromise may yet lead to the unravelling of the Round.

To sum up there is scepticism about the internal consistency of the US' new multi-track approach to trade policy, and especially its compatibility with the evolution of a strengthened GATT.

In Canada, the merits of the FTA with the US continue to be hotly contested. In some respects its timing was unfortunate - being closely followed by the global recession and the appreciation of the Canadian dollar. It is too early for the full effect of the tariff liberalisation to be known. But it has been unable to prevent a substantial drop in manufacturing output, and the closure of several US subsidiaries - indeed many critics would argue it has been a major cause of these changes. (On the other hand, some manufacturing job losses had been expected by its protagonists - for example Sunder Magun and others at the Economic Council of Canada (1988) had forecast net job gains primarily in the services sector; but even their 'worst-case' estimates of manufacturing job losses have been exceeded).

While the liberalisation of access to the US market is being phased in over 10 years, the security provisions came into immediate effect, and have been put to the test on several occasions - especially by Canadian exporters. Most of the panel cases have involved ADD and CVD cases, and have gone in Canada's favour.

A major shortcoming of the CUSFTA, however, was the failure to agree on a common approach to ADD and CVD. The binational appeal process works within the domestic law of the importing country, rather than a new set of common laws. Many smaller exporters consider the binational process expensive and ineffective. And in 1991 Canadian confidence was undermined by the US decision to question a panel's ruling on Canadian pork, under the 'extraordinary appeals' procedure, on grounds which appeared political - to win support for the renewal of the FTA.

The CUSFTA consultation provisions have led to Canada being excluded from potentially restrictive legislative proposals. In the case of safeguards Canada is exempted unless it is a substantial supplier (defined as in the range of 5 to 10% or more) but the rules are vague and their significance is at issue, given the generally declining US use of safeguards. Nor has CUSFTA guaranteed freedom from harassment, especially in areas where no agreement was reached eg intellectual property. Canada has been 'named' under special 301, for its laws on pharmaceutical patents. Moreover the contentious action against Canadian shakes and shingles, negotiated on safeguards grounds, remains in force. (A joint memorandum of understanding, under which US opposition to low Canadian stumpage fees and threat of countervailing action led Canada to introduce a 15% tax on
certain softwood lumber exports, was only suspended by Canada in October 1991. It remains to be seen whether the US will take retaliatory action.)

Canadian participation in NAFTA has been advocated as a damage limitation exercise, to minimise the dilution of its gains in the US market by insisting on tough origin rules and a long phase-in period. But a strategy which is too self-centred will backfire, leading to Canada's expulsion from the talks. Canada's experience underlines one risk in a bilateral strategy ie a country cannot count on the preferential margins it acquires as fixed, even though they have been paid for. These will be diluted by NAFTA and any subsequent FTAs signed by the US in the context of EAI. Canadian participation in EAI may bring some compensation, however, such as increased access to regional markets, the possibility of strengthened, collective, leverage over the US, and a permanent secretariat to service these relationships.

But for Canada the GATT will remain the ultimate forum, for applying multilateral pressure to curb US protectionism. It is too early to determine how CUSFTA has affected Canada's role in the GATT let alone the GATT itself. Determination to push several issues in the Uruguay Round coupled with active coalition-building have increased Canada's authority and its ability to shape the new GATT rules. Unfortunately in the key area of agricultural export subsidies this combined effort has proved unable to draw the US and the EC to a satisfactory compromise.

To elaborate on the implications for developing countries of this regionalist strand in US and Canadian trade policy, it is necessary to distinguish between Mexico and the rest of Latin America and the Caribbean, and developing countries outside the hemisphere.

For Latin America and the Caribbean, entering into a free trade agreement with the US would accelerate the economic liberalisation already initiated by many of them. But there would be some key differences.

i. There would be a shift from multilateral liberalisation to preferential. This would have domestic welfare costs - to the extent that it diverts trade and investment from third countries. Such effects would be diminished as barriers to third countries come down. But it can not be presumed that this will happen with the same momentum, especially if the Uruguay Round collapses.

ii. Latin America would have to make major concessions to the US on trade, investment and other areas of economic intervention, in the hope of securing preferential access to the US market. In fact, according to Erzan and Yeats (1991) the US is likely to
gain more from any FTAs as its exports face much larger tariffs
(average of 20%) and other barriers in Latin America than vice
versa. This would mark a break from the past in which the
developing world made few binding concessions, under the GATT
provisions of relative reciprocity. The range of measures to be
liberalised would also go beyond the scope of those traditionally
dealt with in the GATT. Some have questioned whether this would
be a costly bargain - ie whether extensive liberalisation is
appropriate given that it may compromise industrialisation
efforts, and whether the US will be able to meet its side of the
bargain given the recent Canadian experience.

iii. A FTA with the US would increase Latin American exports by
$2.9bn or 8-9% of current exports to the US (Erzan and Yeats
1991). Removal of NTBs account for 25% of the gains; half would
be lost by any MTN deal with a 50% tariff cut. The amounts are
marginal compared to the possible impact of a FTA with East Asian
NICs as Latin American exports typically face much lower barriers
eg an average tariff of 3-4%. Only 7% of Latin American exports
face a tariff of 5% or more and one or more NTB; whereas for
Korea the share is 55%.

The gains are likely to be relatively concentrated - with 90%
going to Mexico (its exports would expand by $1.6bn or 10%),
Brazil ($950mn or 14%) and Paraguay. Manufactures would increase
by 17% and account for 85% of the total export growth (ibid).
There will also be adjustments between the countries of the
region. In particular some investment is likely to move from the
Caribbean Basin countries, as their preferential status in Canada
and the US is eroded by the extension of free trade to Mexico and
other countries in the hemisphere.

Mechanisms for dealing with possible asymmetries in terms of
adjustment have been raised in the discussions about a NAFTA.
There are various options. The simplest is a slower phase-in of
liberalisation in the less advanced countries, or for less
advanced sectors. For example this has been suggested in the
case of agriculture in Mexico, where an end to the ejido system
could displace large numbers of poor people. Phasing-in would
refer not just to the elimination of border measures, but also to
other forms of government intervention (eg industrial development
subsides).

A second option is the creation of a social fund, to ease the
process of adjustment, following the example of the EC. It could
also address the issue of differentials in labour and
environmental standards, raised in the NAFTA discussions as well
as the Andean Pact, and likely to be on the EAI agenda. Some
have argued that this is inappropriate in a free trade area, and
unlikely to find political support given budgetary constraints in
many countries. But the environment fund proposed by the US as
part of the EAI may form a precedent. And there could be pressure to link aid budgets, such as they exist in the region, to the program for closer economic linkages. Ignoring the possible dislocations arising from liberalisation would undermine its domestic political support as well as the realisation of its economic opportunities.

iv. The impact on regional integration within Latin America has already been alluded to above. Recent work by Erzhan and Yeats (1991) suggests that intra-Latin American trade would be adversely affected by a series of bilateral US-Latin American deals (the 'hub and spoke' model) rather than a plurilateral deal. Even with the latter, the obligation to trade freely with the US (and Canada) may undermine some efforts to develop regional industries. The current revival of the Caribbean Economic Community (or Common Market), for instance, depends in part on the adoption of a common external tariff. A potential conflict may be resolved, however, by a slow phase-in of trade liberalisation with the US.

v. In trade volumes, it is relatively unimportant whether or not Canada is part of this new hemispheric picture - Canada accounts for 1-2% of Latin American exports, for example. But there may be strong political economy reasons for Latin America to favour Canadian partnership. In particular it would help to plurilateralise the relationship - diminishing the probability of the US pursuing a 'hub and spoke' series of bilateral agreements, and replacing it instead with a free trade area with an ever-expanding membership. This would diminish the dominance of the US. Canada would also be able to share its experience of negotiations with the US.

vi. There is a broader political economy issue, namely the implications for relations within the hemisphere, and with the rest of the world. Mexico's decision to negotiate a preferential trade deal with the US appears to have irreversibly broken Latin American solidarity in its international economic and political relations. This may only be partly patched up by parallel trade agreements between Mexico and Chile, for example, and other regional diplomatic initiatives. Acceptance of closer economic links with the US is also likely to weaken Latin American standing in the UN institutions and the Non-aligned Movement. Mexico's influence as a middle power, in particular, may be diminished. On the other hand, many of these organisations are in the process of radical reorientation driven both by the changes in Eastern Europe and the increasing economic pragmatism of many developing countries' foreign policies.

vii. Finally, the GATT will continue to be important for many Latin American and Caribbean countries, and not just for resolving bilateral difficulties with the US in the regional
market. An important area is the extensive US use of agricultural export subsidies in third markets.

Turning to the rest of the developing world, there are two principal issues: trade and investment diversion, and the broader systemic effects.

i. The evidence emerging from various modelling exercises is suggestive rather than rigorous. A key problem is that most fail to distinguish between developed and developing countries in the rest of the world. Thus, for example, Cox and Harris estimate a NAFTA will lead to a very small drop in the rest of the world's share of US imports from 72.73% to 72.09% (1991, Tables 2 and 3). Some sectors would be more affected than others – notably non-metallic minerals, agriculture, machinery and appliances, textiles and leather. (The CUSFTA on the other hand, is estimated to lead to a three percentage point decline in the rest of the world share.) Brown, Deardorff and Stern (1991) forecast a small decline in exports from the rest of the world of $5.3bn following a NAFTA with zero tariffs and a 25% increase in quotas on Mexican exports to the US of agriculture, food and textile products. Erzan and Yeats (1991) estimate that a US-Mexico deal including elimination of tariffs and NTBs would displace imports to the US from Latin America by $28mn, and the rest of the world by $0.5bn. If the MFA is not removed, then trade diversion in the medium term could be virtually limitless.

With respect to agricultural products, Hufbauer and Schott (1992) note the US could increase its sugar, coffee and various horticultural products from Mexico. In the case of sugar this would require the maintenance of barriers against third countries. In the case of coffee, where Mexico is a major world exporter, an indirect effect may be to diminish the already weakening US support for the international coffee agreement.

Some analysts have estimated the impact of an inward-looking NAFTA – whether it be in terms of raising trade barriers, or just delaying trade liberalisation. For instance the Cox/Harris work predicts that if NAFTA introduced a tariff increase of 10% towards the rest of the world, it could lead to a significant 10 percentage point decline in the rest of the world's share in US imports. A recent study estimates that a NAFTA could produce large US job gains, in the order of 225,000 to 264,000, if the agreement allows North American goods to displace imports from third countries (quoted by Hufbauer and Schott, 1992). This is in contrast to the job losses otherwise forecast. Such analysis can become self-fulfilling – ie it may be accepted as essential to buying off domestic opposition to a NAFTA, and fiscally cheaper than any form of adjustment assistance. But there would be a domestic welfare loss, as well as the costs to third countries.
Trade diversion may be exacerbated by attempts to stiffen the rules of origin - as being suggested in the case of autos in the NAFTA discussions. Raising the minimum domestic content to qualify for North American tariff treatment would particularly affect the Japanese and other 'transplant' car factories in North America, which source a lot of their parts from outside the region.

Morici also mentions the possibility of other countries being 'crowded out' (1991) as a result of Article 1102 of the CUSFTA which allows the US, for example, to exempt Canada from global safeguard action (under GATT Article XIX) if Canada supplies less than 5-10% of US imports. Where imports from Canada are still restrained, they must be allowed a certain amount of growth. Allowing similar treatment to Mexico under a NAFTA would in Morici's view aggravate this crowding out problem (p11).

ii. The content of the CUSFTA and NAFTA are likely to influence the evolution of the GATT rules and procedures in various ways. One is issue coverage - the inclusion of rules on investment, access to resources, or movement of certain professional workers, for example. Another is increasing pressure on developing countries to accept reciprocity in trade bargaining. Whether these are considered beneficial or not remains a matter of debate.

On the more general issue of global systemic change - a NAFTA and possible subsequent extensions within the hemisphere have reinforced concerns in many developing countries about the future of the global trading system, and the role of multilateralism. The CUSFTA, NAFTA, and EAI have coincided in Europe with the EC's 1992 program, the creation of a European Economic Space and efforts to incorporate Eastern Europe, and in Asia, with the discussion of a new regional grouping. This is ironic as many developing countries have only recently begun to play an active role in the GATT, offering concessions and helping to design the new rules. Failure to secure major results in the Uruguay Round risks undermining their domestic liberalisation efforts.
7. Conclusions

There are several conclusions one may draw from this analysis of recent changes in Canadian and US trade bargaining, and the drift towards regionalism.

Bargaining over day-to-day trade policy with the US increasingly is being handled in a quasi-judicial way. There is still scope for some administrative or political discretion, but this is being eroded. Flexibility in the application of trade law cuts both ways for developing countries - domestic political interests may be given priority over foreign. Nonetheless the administration is still able to use foreign policy considerations to buy time (eg over China). On the other hand, the development of trade law, both domestically and through the GATT, remains politically charged, with the administration sensitive to pressures in Congress.

The trend in this direction in Canada is somewhat less pronounced. The quasi-judicial process has been rationalised and given greater transparency with the formation of the Canadian International Trade Tribunal. While there have been a large number of cases, several have involved reviews of earlier decisions (eg on antidumping). There is still some political/administrative discretion - day-to-day trade policy is not completely a judicial process.

Understanding these processes in Canada and the US, and the ability to engage in them - politically or through legal counsel - is important for developing countries. It is also critical for them to keep up with the evolution of trade laws if they wish to have any influence. But it may be difficult, expensive and even risky to do this in a high profile way. One strategy is to work with US or Canadian partners - ie retail groups and import-using industries - as well as other countries with common interests.

Some countries have sought to avoid such problems by bilateral free trade agreements. For example the CUSFTA provides for Canada to be consulted before it is included in any proposed change in US trade legislation. Another key element is the chapter 18 and 19 dispute settlement mechanisms. But, while these do not provide complete insurance for Canadian exporters, there is considerable opposition in the US to extending similar treatment (especially chapter 19) to other countries, notably to Mexico.

Of course there are other reasons for pursuing free trade agreements besides more secure access: including speed and greater access. The latter was particularly important to Canada. It calculated that it would be able to move a lot further bilaterally with the US than in the GATT eg on labour-related
services. Speed was also a factor in that the government viewed extensive domestic trade liberalisation as a key instrument of industrial policy. Moreover it wanted to lock these changes in place before there was a change of government. Some have questioned however, whether the government could not have struck a better bargain - i.e. acquired more from the US. Certainly there is a large amount of unfinished business.

There is a dilemma here which faces other countries. Governments, in arguing to domestic constituencies that trade liberalisation is good for the economy, and should be undertaken anyway, risk weakening their demand for 'payment' in the form of improved access to their partners' markets.

For the US the agreement with Canada served as a useful model, for its multilateral agenda, and as a warning to those who would not accept its GATT demands, as well as an invitation to others to follow suit. It is also partly designed as an insurance policy - securing a preferential zone for US exporters in the event of the world trading system becoming more fragmented.

Some of the FTA elements have contributed to the Uruguay Round discussions - a priority also for Canada. It is less clear, however, that the FTA has hastened concessions from other countries like the EC or Japan, with whom the US continues to have major disagreements. Any final deal will be struck on the basis of bilateral bargaining e.g. EC and Japanese agriculture for US 301. It is unlikely that the EC with its European preoccupations will be disarmed by the prospects of a North American trade agreement.

It is also too early to measure the effect of the CUSFTA on Canada's bargaining with its major non-US partners.

The shift to regionalism inevitably has undermined the position of countries who have sought to work through the GATT particularly in dealing with the US. Many have chosen to respond positively to the invitation of the Enterprise for the Americas Initiative. This will not be an easy course to follow. It is not guaranteed to generate more secure or greater access, while there may be a higher price to pay than in the GATT. In particular it will be trade distorting.

Besides the issue of trade distortion, other countries may lose in various ways. First, they too will be expected to pay more for improved access to the US market. Second, there is a strong risk of the GATT system being weakened. Third, fragile regional (South-South) trade efforts may be undermined - even if the EAI is pursued plurilaterally.

A large Uruguay Round package, including strengthening of the institution and its dispute settlement machinery, will diminish some of these concerns by reducing the scope of trade diversion, and reasserting the primacy of the GATT.
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Endnotes

1. The author would like to thank the other participants in the IDRC project on trade bargaining and Prof. G.K. Helleiner for their helpful comments on an earlier draft, and IDRC for its funding.
2. For example, the members of the US Twentieth Century Fund Task Force on the Future of American Trade Policy recommend first the achievement of a trade surplus by 1993, and only second do they refer to the need to boost private savings and reduce the fiscal deficit (see Twentieth Century Fund, 1989, p34).

3. Trade policymaking is also undertaken within the private sector; for example, multinational corporations' management of their activities constitutes a form of trade policy.

4. Finger, 1991, contrasts the openness of the Uruguay Round (with a US delegation of 300 to the meeting in Brussels in 1990) with that of earlier rounds, and questions whether trade liberalisation is possible under these circumstances. 'When trade policy is constituent service it is mostly trade restrictions' (p22).

5. They have been the subject of research by Destler and Odell (1987), inter alia.

6. Nb these figures are generally considered to underestimate foreign lobbying activity as many agents fail to register, and some payments, e.g. to research institutions, are exempt from registration (ibid).


8. For example Kuttner (1989, p17): 'The Administration has never been clear to itself or to its allies, about which of these are temporary adjustment expedients; which ones are merely tactical manoeuvres intended to be bargained away for reciprocal liberalizations; which ones are adjuncts of domestic industrial policies; which ones are craven capitulations to domestic pressure groups; and which are necessary long-term regimes in industries which don't lend themselves to Ricardian trade.'

9. '(T)he division of powers in the US system is ill-suited to managing the details of the economy..... (A)ny attempt to divide the pie would not be on strategic economic and trade criteria, but on political trade-offs that would reflect lobbying skills and masquerade under the rubric of 'fair shares' ' (Lawrence and Schultze, 1990, p31).

10. For example the Economic Council of Canada (1988) found sectoral policies had retarded rather than promoted adjustment to change.

11. As in the US it is important to distinguish between federal and sub-federal policies. The Quebec provincial government in particular has continued to adopt an interventionist industrial policy in various high-tech and other sectors (e.g. aluminum processing and power projects). The Ontario government has also
begun to adopt a more active industrial policy. There are several other examples of provincial support. How far these are compatible with the obligations of the CUSFTA remains to be seen.

12. An initial study by Cox and Harris, 1991, for example, suggests that the gains will be restricted to lower consumer prices. Oligopolies, however, may diminish both the price changes and the productivity gains in cases of foreign ownership.

13. See below.

14. Eg the EC AIRBUS aircraft subsidies and a number of cases against Japan - which some observers feel to have been more successful than various bilateral initiatives.

15. This reflects many smaller countries' frustration with the GATT's dispute settlement process (the ultimate sanction of retaliation still depending on market size) and a preference for resolution through diplomacy.

16. For an articulation of the Canadian view that the time had come to look beyond the GATT to advance Canada's trade interests, see Curtis, 1985, p183. 'Canada's trading relationship with the US will remain central to long-term Canadian economic performance ... bilateral agreements to reduce or eliminate barriers to cross-border trade ... would contribute importantly to long-term investment, production and income growth in Canada'. Curtis also notes the long history of Canada's bilateral deals with the US, dating from the late 1800s. A number of earlier deals with the US had been on a sectoral basis - agricultural machinery in the 1920s, arms production in the 1940s and the 1965 autopact.

17. Magun, 1991, using an export similarity measure shows that there is increasing overlap, with the index rising from 16 in 1971 to 34 in 1987 - where 0 = dissimilar export distribution and 100 = identical export distribution. Nb this analysis is highly static and therefore inadequate for assessing the dynamic impacts of a NAFTA, or even just the potential competition resulting from the restructuring of the Mexican economy.

18. In 1987, immigrants to Canada from Latin America and the Caribbean accounted for 27% of the total, or about a third from all ldc's; this compares with an average of 15%, or a quarter respectively, for 1980-86.

19. CARIBCAN, which began in 1986, offers all Commonwealth Caribbean countries duty-free access to the Canadian market for the bulk of their exports. Major exceptions include textiles and clothing, some leather products, lubricating oils and methanol.
20. nb once Canada (or the US) has decided to pursue a dispute bilaterally under Chapters 18 or 19, it cannot be appealed to the GATT.

21. As of August 1991, a common market, Mercosur is envisaged to be in place by 1995, bringing together Argentina, Brazil, Paraguay, Uruguay and possibly Bolivia; a free trade zone by 1994 between Colombia, Mexico and Venezuela; a free trade zone by 1996 between Mexico and the Central American countries; while the Andean Pact has been revived by Bolivia, Colombia, Ecuador, Peru and Venezuela.

22. 'A comprehensive Free Trade Agreement for Latin America is our long-term goal. We are prepared to enter into FTAs with other markets in Latin America and the Caribbean -- particularly with groups of countries that have associated for purposes of liberalisation.'

23. There have been other disputes but many have been dealt with by the binational commission without referral to a panel.

24. The Canadian Chambers of Commerce has proposed following the example of Australia and New Zealand who now apply domestic competition law to disagreements over dumping.

25. There are some parallels here with the lessons developing countries have had to learn with the GSP, though the expectations with the GSP should never have been as high, given that they were a unilateral concession.

26. See for example, Helleiner 1990, mimeo, and the work emerging from the 'Trade and Industrialisation Revisited' project being directed by Helleiner.

27. I am grateful to David Pollock for making this point.

28. The content rules were raised in the CUSFTA.